

2002

Sir Joseph Gold and His Times

Robert C. Effros

Follow this and additional works at: <https://scholar.smu.edu/lbra>

Recommended Citation

Robert C. Effros, *Sir Joseph Gold and His Times*, 8 LAW & BUS. REV. AM. 9 (2002)
<https://scholar.smu.edu/lbra/vol8/iss1/3>

This Preface is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

Sir Joseph Gold and His Times¹

*Robert C. Effros**

Table of Contents

- I. Introduction
- II. Some Basic Concepts: The Balance of Payments, the Gold Standard and Its Alternatives
- III. The Background of Events
- IV. The Negotiation of the Fund's Articles of Agreement
- V. The Structure of the Fund: Its Four Aspects: Gold's Reflections and Contributions
- VI. Clouds on the Horizon During Gold's Tenure: The First Cloud: Disproportion of Reserves to World Trade and the First Amendment's Creation of the Special Drawing Right
- VII. The Second Cloud: The Demise of the Par Value System: Gold's Counsel to Avoid a Legal Vacuum
- VIII. The Second Amendment to the Fund's Articles of Agreement: Gold's Role as Chief Legal Draftsman
- IX. Epilogue

Joseph Gold joined the Legal Department of the International Monetary Fund in 1946 and served as the Fund's General Counsel from 1960 until 1979 when he retired from active service to become its Senior Consultant. During nineteen years of his tenure, he served as the most senior staff member of the Fund. In this capacity he participated in the general strategy of the organization and oversaw nearly every one of its significant decisions. The times during which he served were stormy and momentous, characterized by local as well as more general economic problems and haunted by the potential for serious world financial crisis. History records the initial dollar shortage suffered by war torn Europe and the less developed countries, the related payment imbalances experienced by so many countries seeking to gain or regain a level of comfort for their citizenry, the reversal of the dollar problem when it appeared that the U.S. balance of payments deficit had led to an apparent dollar glut among the recovering developed countries, the fear that the solution of this deficit would once again lead to a shortage of dollars and a lack of the liquidity needed to finance world trade, a potentially catastrophic failure of the par value system and the gold exchange system that underlay it, and the radical reconstitution of the failed framework. Every year new and unexpected challenges beset the world's financial system. Even as old problems like exchange restrictions, multiple

* Robert C. Effros, International Monetary Fund, Legal Department, Washington, DC.

¹ The opinions expressed in this paper are those of the writer and do not necessarily express the views of the International Monetary Fund.

currency practices, and inadequate adjustment financing were being addressed, new phenomena appeared both as problems and as solutions: Eurodollars, petrodollars, capital flight, international banking, and debt problems were added to the panorama. Despite these worrisome challenges and the particular setbacks that they sometimes produced, by more general yardsticks the standards of well being increased for many of the countries and their inhabitants and the kind of worldwide economic disaster that had characterized the 1930s never materialized. Was the world merely fortunate in the postwar years, as it had previously been unfortunate prior to the war, so as to suggest a sort of equilibrium in the affairs of mankind? Or is it possible that the adroit use of new knowledge and analysis and the skillful fashioning of new remedies contributed to the welcome outcome? It is the purpose of this paper to inquire more closely into these questions.

A caveat is necessary to the reader: It is not within the scope of this paper to provide an intensive analysis of the intricacies of the International Monetary Fund or to chronicle in detail the history of the era. Such an effort would require many more pages.² The paper is, however, intended to describe some of the issues and the responses to them in which Gold and his colleagues³ played a major role, and to place the man in perspective with his times. In order to appreciate these issues, a summary of some of the features of the Fund is offered and quotations are provided from Gold's works on its various aspects.

I. Introduction

Joseph Gold, who was to be knighted by Queen Elizabeth at the height of his career, was born into ordinary, and by today's standards, even humble circumstances. His birth occurred shortly before the First World War at a time when the world was at peace, a belief in progress was premised, and ever rising standards of prosperity and culture were taken for granted. At that time, the international economy was based on a regime called the gold standard whose laws were thought to operate automatically and benignly to adjust the temporary disequilibria that, like the inevitable friction in a motor, was thought part of the workings of a vast and yet orderly machine. The family into which he was born was close, and from it he soon learned to appreciate the importance of careful analysis and its application to life. In one of his accounts, he liked to recall that his father was not merely content to regard the outcome of a game of chess or cards with moot acceptance. Instead, his father would analyze the moves and ask the young son to consider whether, if the cards had been different, or the pieces had been played with another stratagem, how the outcome of the game would have been affected. As the young man matured, it became apparent that he was a person of promise and energy whose personality combined features that are commonly believed to be at odds

2. The reader is particularly referred to the references cited in the footnotes to this paper.

3. Gold served under several Managing Directors and Deputy Managing Directors of the Fund. He interacted closely with a number of Executive Directors and senior members of the staff. Particular mention should be made of Mr. J. J. Polak, who was the Economic Counselor during much of the time covered by this paper. Gold was followed by two distinguished successors, Mr. George Nicoletopoulos and Mr. Francois Gianviti, who is currently the Fund's General Counsel.

with one another. He had, people observed, both a predilection for precision and a flair for originality. His skills were sharpened in early education and then honed by legal training first at London University, and subsequently, at Harvard University. It should be noted that in London in the thirties he was part of a small group of teachers and students that thought that law must not merely be an arid exercise of logic, but rather, should serve broader functions in the promotion of welfare.⁴ Here was the germ of the philosophy that would motivate his actions then and in later life: The logic of the law should be harnessed to economic realities for the betterment of society. He and his colleagues founded the *Modern Law Review*, a legal journal that espoused this cause. He taught a number of subjects at the universities but found he was particularly interested in contracts, a subject that would foreshadow his contributions to the development of the standby arrangement, an important and innovative method of financing the member countries of the Fund.

II. Some Basic Concepts: The Balance of Payments, the Gold Standard and Its Alternatives

Before proceeding with the narrative, let us recall our understanding of some basic concepts. A country's *balance of payments* for a given period can be defined as a systematic record of all economic transactions during that period between residents of the reporting country and residents of other countries. Ordinarily it is prepared in double entry form much as the familiar balance sheet. The accounts are broken down into current account items and capital account items. Current account items include trade in goods and services. Capital account items are broken down into short and long term capital movements and may be illustrated, for example, by the transfer of securities. From the standpoint of an exporting country, its sales (or exports) are recorded as credit items, while its purchases of goods, services, and securities are recorded as debit items. The balance of payments must always balance, even as a balance sheet must strike a balance. Thus the total in the balance of payments on the credit side must always equal the total on the debit side. This does not mean, however, that the individual items or classes of items must balance. Thus the export of goods may not equal the import of goods, the export of goods and services need not equal the import of goods and services, and there is no reason why the total of capital inflow need be identical to the total figures for capital outflow. However, the total of the current and capital accounts on the credit side of the balance must equal the total of the current and capital accounts on the debit side. If the two sides must balance, the necessary implication must be that any given country always obtains the funds that it needs to pay for all of its purchases.

If a balance of payments must always balance by definition, what can ever go wrong? Circumstances may arise when a country's income in the form of foreign currencies earned from its sale of goods and services, and its reserves of gold and foreign currency, as well as its credit standing abroad when combined are not sufficient to allow it to

4. See Editor's Tribute by J. J. Norton, 23 INT'L LAW. 799 (1989), constituting an introduction to the subsequently published Festschrift in Honor of Sir Joseph Gold (1990) (ed. Ebke and Norton).

purchase all that it needs from other countries. It may have four responses.⁵ One response may be to impose controls or restrictions to hold its imports to an unduly low level. The result will be a balance struck at a lower level than otherwise would be desirable for the welfare of the country. In such a case, needed foodstuffs, fuel or raw materials that would ordinarily be imported may be foregone at a cost to the domestic welfare. A second conceivable response would be to deliberately run down reserves that had accumulated as a result of exporting more goods and services than had been imported. Such a course can only gain temporary respite because, if it is not reversed, it will ultimately lead to the exhaustion of the country's reserves without solution of the underlying problem that has given rise to the disequilibrium in the balance of payments. A third response would be to borrow abroad in order to maintain the necessary level of imports. This option is available only if there are foreign lenders who are willing to extend the needed credit, and only so long as they choose to continue to lend. Once again it is unlikely to prove more than a temporary expedient. A fourth possibility is the receipt of foreign gifts and donations. Aid programs that might supply such grants do exist, but again, they cannot be depended on indefinitely.

We have made reference to the *gold standard*. This was a system that much of the world relied on in the nineteenth century, and into the early part of the twentieth century, to foster and adjust the balance of payments of the countries participating in it. Under this system the currency of each country was fixed in its value to gold. Thus a dollar might be worth so many grains of fine gold, since it either contained that weight of gold if it were metallic or, if it were paper, could be exchanged for the metal coin. A pound sterling would similarly be valued in gold for the same reasons. The consequence was that the dollar and the pound (and any other currency similarly valued) could be exchanged for one another at a known fixed ratio. This led to a further result. If, in a given year, British exporters sold more goods and services to American importers than British importers bought from American exporters, they could turn the excess dollars received into pounds, and ultimately the Bank of England could demand the amount of gold represented by such funds from the American authorities. The latter might satisfy this claim by shipping the gold to London in exchange for the amount of dollars that had found their way into the holdings of the Bank of England. Alternatively, the British exporters could tender the excess dollars directly to the American authorities in return for gold, and have the gold shipped to England.

If this process continued, the United States would be seen to be losing gold in order to maintain its desired level of imports from Britain. In effect, this would be an example of the second method of satisfying the balance of payments discussed above. The United States could not do this indefinitely. The appeal of the gold standard was that it would enforce a correction to these circumstances. It would do this in the following way. (1) The U.S. money supply would be reduced by the shipments of gold (since the money supply comprised either gold coins or paper currency that was issued in direct proportion to it on the basis of gold held at the central bank); (2) the resulting reduced supply of money would lead to lower prices and wages in the U.S.; (3) American imports of goods and services (from Britain, as well as elsewhere) would decrease, since these goods and services would become relatively more expensive by comparison to the

5. See TARSHIS, INTRODUCTION TO INTERNATIONAL TRADE AND FINANCE, at 294-295 (1955).

domestic American prices for similar goods and services; (4) U.S. exports to Britain (and elsewhere), would increase because U.S. products had become relatively less expensive than competing foreign products in the markets abroad.

The gold standard had an understandable appeal. In theory it would operate automatically and work the necessary adjustments in the balance of payments of countries. Just as in nineteenth century physics, the Newtonian universe appeared to operate like an automatic mechanism without direction, so in international economics, there appeared to be a corresponding machine that insured a self correcting mechanism tending automatically towards equilibrium. There were, however, problems in practice. First, the model may not work smoothly. Thus step (2) which posits lower prices in the debtor country may founder if prices and wages prove obdurate. Secondly, since the adjustment is implemented by internal adjustments that typically result in a contraction of the economy, those affected by such adjustments and their political representatives may take action to halt the adjustment. If industry is to retrench, and workers are to lose their jobs, or have their pay cut, they may resist the indicated adjustments so as to thwart the mechanism of the gold standard.⁶

Alternatives to the gold standard are known. Basically they fall into two main categories: (1) *flexible exchange rates*, and (2) *government controlled exchange rates*.

In a system of *flexible exchange rates*, the currencies of countries are left to form their own relations as a result of fluctuations in their demand and supply. In our example, if demand for British goods rises in the U.S., then demand for the pound sterling will similarly rise in order for importers to purchase such goods for their customers. The result will be a change in the ratio of the dollar to the pound, with the value of the latter falling relative to the value of the dollar. Like the gold standard, this system works automatically towards a self correcting equilibrium, since the consequence of such a shift in the relative values of the two currencies will be that British goods will become more expensive in the U.S. markets, while American made goods will become less expensive to British importers. Moreover, it has certain advantages over the gold standard. It works without the initial need to change domestic prices, wages, and interest rates (although changes in these parameters may follow). Furthermore, it operates without the need to transfer gold in settlement of the balance of payments between the two countries. However, economists and businessmen discerned a disadvantage in the floating exchange system. Importers, exporters, and producers of goods and services for foreign trade had to deal with an additional factor when attempting to calculate their margin of profit, and hence the price that they should charge their customers. This additional factor is the risk that exchange rates may change to their detriment during the time of their contract.

In a system of *government controlled exchange rates*, one or more countries may decide to fix their exchange rates in relation to one another. In order to maintain the relationships, the governments may buy and sell their own currencies in the markets. Thus if the U.S. authorities decided to maintain a fixed relationship of the dollar to the pound, they would purchase dollars in the markets with pounds (or other foreign currencies) from the official reserves if the pound rose (i.e. the dollar sank) above the fixed relationship. In this way they would be decreasing the supply of dollars in the markets so as to raise its price to the desired level in terms of the pound. The policy

6. See LOEWENFELD, *THE INTERNATIONAL MONETARY SYSTEM* 10 (1977).

would be reversed if the dollar tended to rise above the fixed relationship of the two currencies. The U.S. authorities would sell dollars in the markets against pounds, so as to increase the supply of dollars in those markets and drive down the price of dollars in terms of pounds. This mechanism may help to insulate the domestic economy (of the U.S. in our example), from the need of making underlying adjustments, at least in the short term. However, the strategy can work only so long as the U.S. authorities have, or can obtain, a supply of official foreign exchange reserves from which to draw. The strategy also presupposes that the fixed relationship that the authorities have selected and committed to defend is realistic, and based on a proper consideration of the relative terms of trade. If the fixed relationship is not realistic (or not seen to be so by market participants), it will need at some point to be changed. This change may take place through a devaluation (reduction in value), or a revaluation (increase in the value) of the currency. It should be noted that in an attempt to defend the fixed rate, a country may use other methods. Thus it may require exporters to surrender all foreign exchange to the central bank, and then allocate such exchange to importers according to some schedule of preferences.

The gold standard had been adopted by Great Britain and had been followed by many other countries. The exigencies of the First World War forced the abandonment of the gold standard by countries that had to marshal all their strength regardless of economic niceties. Great Britain attempted to resume its adherence to the gold standard after the conclusion of the war, but permanently abandoned it in 1931. By this point the Great Depression had struck. Over the next decade, the world experienced its greatest collapse of commodity prices and shrinkage of world trade. In the three years between 1929 and 1932, the world price index fell by 47.5 per cent and the gold value of world trade fell by 63 per cent.⁷ Faced with deflationary pressures, many countries sought ways to defend themselves. One way adopted by many countries, sooner or later, was to devalue the currency. This led to a spiral of competitive devaluations among the countries and the introduction of restrictions on trade and exchange.

III. The Background of Events

As early as 1942, the U.S. and U.K. authorities were circulating to each other plans for the postwar international financial framework that would eventually give rise to the International Monetary Fund. By this time the verities of progress, prosperity, and enlightenment that had been everyone's birthright in an earlier generation, had been swept away under the relentless battering of two world wars, punctuated by the most severe depression that the world had ever known. But now a new vision was needed, one that would accord with Winston Churchill's wartime evocation of a post war era into which the nations would be ushered, an era of "broad, sunlit uplands." Negotiations for the establishment of new international institutions had proceeded apace as the Allied governments considered what the shape of the postwar economic arrangements should be. It was recognized by all that the world could not merely resile into the dysfunctions of the thirties. Then when general economic disaster had struck in the form of the

7. See HORSEFIELD, *INTERNATIONAL MONETARY FUND 1945-1965* vol. I, at 4 (1969).

Great Depression, there had been little, or no, coordinated effort between the nations for recovery. Instead, unfettered economic nationalism had led to destructive competition between them. Countries reeling in a vortex of unemployment and idled industry, had sought to promote their products abroad, while simultaneously keeping those of other nations from entering their ports. It was obvious that such policies were inherently contradictory, since a trading partner needed ways to earn the wherewithal to pay for the exports it purchased. If the exporting country denied its importing partner the way to obtain the funds needed to pay for the exports, it could hardly expect its partner to continue to buy its products. Nevertheless, countries had persisted in this ill-considered strategy. They had done this by a variety of ways, imposing obstructions to both trade and to payment. Trade measures to accomplish these goals were already well known. Tariffs could be raised to make goods from abroad more costly in the home markets, and quantitative ceilings could be directly applied to keep the foreign goods out. But trade obstacles were not the only way to protect and foster the home industries. Payment was the other side of trade. The exchange value of one's currency could be devalued so that the nation's goods could be sold at cheaper prices in markets abroad, thus underselling those of the foreign competitors. Exchange restrictions could be mandated so that importers in the home country would be unable to obtain the foreign exchange needed to purchase imports from abroad. In the end, all these measures, designed to hinder international trade both directly and by erecting hindrances to payment, had had their effect. During the depression years world trade had shrunk precipitously. Instead of providing an elixir to recovery by stimulating demand for production, each nation's beggar thy neighbor policies had resulted in a general diminution of demand, and a further idling of men and machines. Hard times had only led to radical political solutions. Demagogues who would have been summarily ignored in more normal times, had stepped forward out of the misery and chaos. They had espoused irrational causes, ranted at scapegoats, and imposed a lawless uniformity by force. Lines had been drawn and overstepped, and finally, the world had experienced the savagery and evil of the Second World War. Allied statesmen knew that this cycle of events could never be allowed to repeat itself.

IV. The Negotiation of the Fund's Articles of Agreement

Negotiations between the U.S. and U.K. authorities proceeded apace. Consultations were held in Washington from September 15 through October 9, 1943. These led to a Joint Statement that was published in April 1944, and a preliminary drafting conference at Atlantic City in June. A land mark meeting was convened on July 1, 1944 at Bretton Woods, New Hampshire, with delegates from 44 members of the United and Associated Nations, and others in attendance. The purpose of the meeting was to consider the shape of the postwar economic arrangements, and to hammer out the constituent documents necessary to create it. Although two institutions resulted from the deliberations of the participants, in fact three had been envisaged. The two international financial institutions that were established were the International Monetary Fund (IMF or "Fund") and the International Bank for Reconstruction and Development (IBRD). The third institution that was envisaged was a world trade organization, some of whose functions were performed over the years by the General Agreement on Tariffs and Trade (before the

establishment of the World Trade Organization in recent years). The IBRD, which soon became known as "the World Bank," was intended to make long term loans for specific projects, like dams and highways, to countries that had suffered damage during the Second World War, and to countries in the process of development. The IMF was to provide temporary financial assistance to countries experiencing balance of payments problems in order to tide them over difficult periods during which adjustments could be made to their underlying economic problems. In addition, the IMF was to preside over a set of rules that would provide the framework of the international monetary system. The inaugural meeting of the Boards of Governors of the IMF and the IBRD was convened in Savannah, Georgia on March 8, 1946. Before the year was out, Joseph Gold joined the Legal Department of the Fund. His rise in an organization of many talented colleagues would be rapid and sustained.

V. The Structure of the Fund: Its Four Aspects: Gold's Reflections and Contributions

Upon entering Gold's office, one's attention was drawn not to standard landscapes or exotica from foreign travels that could sometimes be found in other offices of the Fund. Instead, one was faced with an imposing mobile of the type that Calder invented and popularized. Many of the visitors to Gold's office were acquainted with this type of abstract art from illustrations and, perhaps, museums of the contemporary. However, it is unlikely that they owned, or that their acquaintances owned, such art forms. Gold was a modern man, a collector of fine books, with a taste for contemporary and avant-garde literature. But the mobile in his office seemed more than a fashionable token of the times. With its many seemingly independent pieces, each delicately suspended with great care and precision to form a balanced whole of interrelated components, the mobile must have symbolized much more than abstract art to the stream of thoughtful visitors who daily sought his counsel in their ongoing efforts to wrestle with the problems of the international monetary system. That system too, was composed of many independent countries, seemingly autonomous and unrelated, but in reality forming a complicated abstraction of mutual interdependence that, like the mobile, could be stirred by every passing breeze. It was to address this reality that the complex mechanism of the Fund was created.

Traditional analysis of the Fund distinguishes four basic aspects of the institution: (1) *the rules of conduct* over which it presides, (2) *the financial assistance* that it provides member countries, (3) *the forum* it provides for discussion of matters of common concern, and (4) *a source for international liquidity* (a feature subsequently added, whose function has yet to be fully realized). In what follows, we will review these aspects and consider Gold's reflections and contributions concerning them, drawing from his published works and focusing on those matters that particularly engaged his interest.

The first aspect of the Fund that invited inspection was the notion of rules of conduct that would form a framework for the postwar international monetary system. Rules suggest a legal connotation, and the reader may well appreciate the role that the General Counsel must play in their development and elucidation. The interpretation of these rules was often the main work on Gold's desk. A guiding principle of the rules would be that rates of exchange between currencies are not manifestations of unfettered sovereignty to be

left to each country to determine unilaterally, without regard for their effect on other countries or the system in general. Rates of exchange, by their nature, bear on more than a single currency and hence, are matters of international concern. Accordingly, each member country of the Fund would be obliged to declare a par value of its currency in terms of gold (or in terms of the U.S. dollar which itself was defined in gold). This par value would be established with the assent of the Fund. A member that had declared a par value for its currency would then be bound to see this value respected in its exchange markets in relation to all other member currencies, so that the rates of exchange were within one per cent of the par value for spot exchange transactions.⁸ This obligation would ordinarily be carried out through the sale and purchase, by the authorities, of one or more intervention currencies against the domestic currency (rather than through mere legal prescription or exchange control). By way of example, if the pound were falling and threatened to go below the allowed margin, the Bank of England would purchase pounds on the exchange market with U.S. dollars which it had selected as its intervention currency for this purpose. The effect would be to create additional demand for the pound, thus driving its price up. If, on the other hand, the pound rose on the exchange market and threatened to exceed the allowed margin, the Bank of England would sell pounds on the market. The effect of this action would be to increase the supply of pounds on the market so as to drive their price down.

While countries were generally bound to defend the declared par value of their currency in their foreign exchange market, so as to keep within the permissible margins, an exception was made for any country whose monetary authorities, for the settlement of international transactions, freely bought and sold gold within prescribed limits. Such a country was deemed to be complying with the obligation to defend its currencies within the prescribed margins. The United States did so purchase and sell gold to the monetary authorities of other members, and hence was deemed to be fulfilling the obligation to defend its currency.

A change in the par value of a member's currency could be made only on the proposal of the member and after consultation with the Fund. Provisions were made to accommodate minor changes in the par value, but a major change would require Fund approval on penalty of being declared ineligible to use the Fund's resources.

The par value system had a further corollary. It assumed that the normal situation where a country had a unitary rate was desirable, and that multiple rates of exchange were tolerable only as temporary deviations. Multiple rates were sometimes adopted by countries to give preferred status to different categories of imports or exports, or to distinguish between those applicable to imports and those applicable to exports. Their effect required a bureaucracy to interpret the applicable regulations, encouraged attempts at subterfuge and corruption, engendered inefficiency in trade and settlement, and ultimately undermined the confidence in the currency that employed them. Accordingly, multiple rates were generally discouraged (although provision was made for their retention following a member's entry into the Fund, and for their introduction thereafter with the Fund's approval).

8. A spot transaction is one in which settlement must occur within 48 hours of entering an exchange contract.

Another important rule of the new international monetary system was that member countries were required to avoid restrictions on the making of payments and transfers for current international transactions, unless these restrictions were authorized by the Fund. (By contrast, the Fund's Articles allow members to impose controls on capital transfers).⁹ A great body of jurisprudence grew up around the obligation of members to avoid restrictions on the making of payments and transfers for current international transactions, and Gold was a major contributor to the development of the concepts. Thus, a restriction was understood to mean a direct governmental prohibition of, limitation on, or hindrance to the availability or use of exchange in connection with current international transactions. A restriction was distinguished from a control (which might merely consist of a procedure that was incident to a payment or transfer of funds). One type of control that did not rise to the level of a restriction, was a surrender requirement according to which residents were obliged to surrender to the authorities the foreign exchange proceeds of current international transactions. Moreover, the obligation to refrain from exchange restrictions was considered applicable to out-payments, but not to prohibit the regulation of in-payments by prescribing the currency that residents must receive. The obligation to avoid restrictions applied to transfers as well as payments, and this necessitated finding a precise meaning for transfers. In the end, the concept was understood to mean the ability of a nonresident to convert the proceeds of current international transactions without the risk of their being blocked.

Another rule that was introduced, was that member countries were under obligation to avoid discriminatory currency arrangements. In practice a discriminatory currency arrangement often involved a restriction or a multiple currency practice.

Although the concept is distinct from these other concepts, its interpretation was not so difficult as the other categories of prohibited exchange practices, and it did not give rise to the body of jurisprudence that attended the definition of the other categories.

It should be noted that the Articles of Agreement of the Fund distinguish between two groups of members, those prepared to accept the obligations of Article VIII, Sections 2, 3, and 4, and those that are not yet prepared to do so, and are therefore, under the less demanding regime of Article XIV. Countries that opt for Article VIII status are subject to the rules that prohibit currency restrictions, multiple currency practices, and discriminatory currency arrangements (although the Fund maintained the authority to approve them). Countries that opted for the transitional arrangements of Article XIV are entitled for balance of payments reasons to maintain the restrictions that they had when they entered the Fund. While they may maintain and adapt such restrictions, they cannot introduce new ones without the prior approval of the Fund. Any changes in multiple rates must be submitted to the Fund for prior approval.

9. Payments for current transactions are defined in Article XXX (d) of the Fund's Articles where it is provided that the Fund, after consultations with members, may determine whether specific transactions are to be considered current or capital transactions. For a discussion on proposals to liberalize capital movements, see GIANVITI, *THE INTERNATIONAL MONETARY FUND AND THE LIBERALIZATION OF CAPITAL MOVEMENTS*, in *CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW*, at 7 (1999).

Gold wrote many articles on the rules of the Fund Agreement and their implications. In a classic summation of the rules of conduct and their intended effect, Gold stated:

The broad effect on private parties of the rules of conduct that bind members can be summarized as follows. Those rules seek to give reasonable assurance that private parties can deal among themselves on the basis of fixed, unitary, and stable rates; that they will be able to make payments freely for current international transactions as defined extensively by the Articles; that they will be able to enjoy freely the proceeds of such transactions; and that they will not be subjected to discriminatory currency treatment in connection with those transactions.¹⁰

Before leaving the subject of the rules established for the framework of the international monetary system, we should make mention of one that caught the interest of courts and legal scholars throughout the world, and was of particular interest to Gold. This is the rule that is set out in Article VIII, Section 2(b) of the Fund Agreement:

Exchange contracts which involve the currency of any member, and which are contrary to the exchange control regulations of that member maintained, or imposed consistently with this Agreement, shall be unenforceable in the territories of any member.

Before the Fund Agreement took effect, there was reluctance by the courts of one country to apply the foreign exchange controls of another country. This was the case even though the controls might be found to be part of the governing law according to the private international law of the forum. Sometimes exchange controls were referred to as "revenue," "penal," or against the public policy of the forum. Although the rationale might differ, the result was often the same: disregard by the forum of the exchange controls of other nations.

The rule stated in Article VIII, Section 2(b) was controversial, since it seemed to run counter to the traditional reluctance of courts to grant recognition to foreign exchange control regulations of other countries, and its effect was seemingly to reverse one of the purposes of the Fund. Article I of the Fund Agreement states that one of the purposes of the Fund is to assist in the termination of restrictions in foreign exchange regulations that impair international trade. However, the Agreement also recognizes that it might be necessary for a member to retain or impose exchange controls for a time after that member joined the Fund, and even subsequently, during periods of stress. This is the rationale of Article VIII, Section 2(b). In an effort to clarify certain complexities of the provision, the Fund's Board of Executive Directors issued an interpretation on June 10, 1949. The interpretation sets out the principle that if the exchange controls of a member country are consistent with the Fund Agreement, then exchange contracts involving the currency of the member contrary to its controls should be unenforceable in the courts and administrative bodies of all Fund members.¹¹

The provision has given rise to more cases and more discussion among legal scholars than any other provision in the Fund Articles. The courts of countries have divided on the interpretation of its language. In particular, tribunals in France and Germany adopted the view that "exchange contracts" should be given a broad interpretation, and

10. GOLD, *THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS* 16 (IMF:1965).

11. IMF, Doc. No. 446-4 (June 10, 1949).

should mean contracts that affect a member's exchange resources, while courts in the U.S. and the U.K. have taken a more restrictive view of the concept. The courts have also divided on when a members' currency is involved for the purpose of understanding the meaning of "involving the currency." A third issue is the significance of "exchange control regulations."¹² Gold wrote extensively on Article VIII, Section 2(b), analyzing the cases and commenting on their rationale. While other distinguished legal commentators sometimes counseled more restrictive interpretations, Gold took an expansive view of the meaning of "exchange contracts" and wrote that a currency is "involved" if "the currency is the currency of the member in which there is an effect on the balance of payments or on exchange resources."¹³

*The second aspect of the Fund that we will touch upon is the financial assistance that it makes available to its member countries.*¹⁴ In accordance with its purposes, the Fund may make its resources temporarily available to its members in order to provide them the opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity. In other words, the solution to a balance of payments problem would be undertaken during a period of time in which the Fund would provide financial resources, so as to allow the member to make needed adjustments without the jarring effects that some countries had experienced historically. A brief explanation of this process is in order to provide background to the development of the stand-by arrangement.

When a country joins the Fund, it is assigned a quota on the basis of its economic size and characteristics relative to other members of the organization.¹⁵ This quota is used for several purposes, including establishing its voting power and fixing the size of its subscription to the capital of the Fund. One quarter of the quota subscription of each member is normally payable in reserve assets (originally in gold, but since the Second Amendment of the Fund's Articles, in SDRs or currencies of other members) while the remainder is payable in the member's own currency. The sum of the quota subscriptions (and any additions thereto consequent to subsequent quota increases) constitutes the pool of assets held by the Fund and available to finance member needs. (These assets may

-
12. Gianviti has pointed to four issues of importance. These include the three mentioned above as well as "whether a court should recognize the exchange control regulations that were in force when the contract was entered into or the regulations in force at the time of the proceedings." See GIANVITI, *THE FUND AGREEMENT IN THE COURTS*, VOL. 1 OF *CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS* 1, at 8-13 (1992).
 13. See, for example, GOLD, *THE FUND AGREEMENT IN THE COURTS*—X 483-484 (1972). For a different view suggesting that the broad meaning of "exchange contracts" may be too broad, see Gianviti, *supra*, at note 10 on page 10.
 14. For further elucidation of these matters see *Financial Organization and Operations of the IMF*, pamphlet series no. 45 prepared by the Treasurer's Department of the IMF (1998). See also GIANVITI, *MEMBERS' RIGHTS AND OBLIGATIONS UNDER THE IMF'S ARTICLES OF AGREEMENT IN CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS*, vol. 3, at 1, 7-13 (1995). Additional explanation of the Fund's financial assistance to its members is provided in GIANVITI, *SOME SPECIFIC LEGAL FEATURES OF THE INTERNATIONAL MONETARY FUND IN CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS*, vol. 4, at 1-10 (1997).
 15. Initial quotas for original members of the Fund were determined at the Bretton Woods conference and set out in Schedule A of the Fund Agreement.
-

also be supplemented through borrowing arrangements that the Fund has established with some of its members). That part of a member's quota that is paid in reserve assets becomes its initial reserve tranche (and subsequently is determined by the amount that a member's quota exceeds the Fund's holdings of its own currency). A member can draw up to the full amount of its reserve tranche at any time, upon representing to the Fund that it has a balance of payments need.¹⁶ It does this by transferring an equivalent amount of its own currency, so that the transaction takes the form of a purchase that the member is obliged to reverse by repurchase of its own currency. While the Articles provide that the Fund may prescribe that a repurchase shall be made within a period beginning three years, and ending five years after the date of a purchase, provision is also made (in the amended Articles) for the Fund to change these periods by a qualified vote.¹⁷ A member's reserve tranche is itself considered part of its international reserves, and a drawing of it does not constitute a use of Fund credit. However, access to additional resources constitutes the use of credit tranches that are measured as segments, each equivalent to 25 percent of quota. While originally, there were but four credit tranches, over time additional amounts have been allowed. The Fund attaches conditions to the use of these credit tranches that become more stringent in nature as the member's purchases become larger.

The Fund's Articles envisaged that the resources of the organization would be available to its member countries through a process of purchase and repurchase. This was a straightforward method of financing to deal, for the most part, with the immediate needs of a country. But what if the country did not at present need the funds, although it foresaw a need over a period of time to have the assurance that it could make drawings in the credit tranches if these should become necessary? Another method of financing might furnish the answer.

As early as 1943, in the discussions that had preceded the Bretton Woods conference, a suggestion had been made that the Fund should be able to make a firm commitment to supply a limited amount of foreign exchange to a member, to be renewed or not, at the Fund's discretion at some point during the term of the commitment.¹⁸ After an initial startup period, in which for a variety of reasons there had been only sparse drawing by members of resources from the Fund, the Fund staff had begun to search for a more flexible way than outright purchase–repurchase transactions to make these resources available. This led to the invention of the *stand-by arrangement* in 1952, when the then Managing Director stated to the Fund's Board, the desirability of a means by which as a result of discussions between them, a country would not necessarily make an immediate drawing, but would receive from the Fund assurance that it would be able to make a drawing within a prescribed period of time should the need present itself. By October 1 of that year, the Fund was able to take a decision on the modalities of the new instrument. Over the years the instrument was refined and developed, and increasingly, it was used as the means to provide short-term balance of payments assistance for deficits

16. Requests for reserve tranche purchases are not subject to challenge by the Fund. See Article V, Section 3(c) of the Fund's Articles of Agreement.

17. See Article V, Section 7(d).

18. See HORSEFIELD, *supra*, at 69 and 328.

of a temporary or cyclical nature. After the Second Amendment of the Fund's Articles, express mention of it was made in the Fund Agreement by providing its definition.¹⁹

Gold had participated in the development of the stand-by arrangement and over the years wrote extensively concerning it. He was particularly concerned with its legal characterization. The primary issue that concerned him was whether a stand-by arrangement constituted an international agreement between the Fund and a member:

The issue to which most attention has been devoted, has been whether a stand-by arrangement is the Fund's acceptance of a member's offer to pursue a certain program in the sense that offer and acceptance have in the law of contract; or, in other words, whether stand-by documents constitute an international agreement between the Fund and a member, that obliges the member to observe the objectives and policies contained in its letter of intent. If the answer were in the affirmative, the member would be in violation of obligations undertaken toward the Fund if the member did not observe its declared objectives and policies.²⁰

Gold's conclusions, as was his wont, took account of law, economics, and politics. They were set out in a tightly reasoned monograph.²¹ To give some appreciation of his method of analysis, it is appropriate to summarize them for the reader. Gold reasoned as follows: The legal characterization of the stand-by arrangement is important because it has practical and political consequences. The legal analysis must take account of the responsibilities of the member and the Fund. It is the responsibility of the former to select and to follow its economic and financial policies and objectives. The responsibility of the Fund is to satisfy itself that these policies and objectives will be consistent with the Fund's Articles and its policies. A member sets out its objectives and policies in its letter of intent, which it addresses to the Managing Director, and the Fund by its decision, sets out the terms on which the member may draw under the stand-by without further review by the Fund. The letter of intent and the Fund decision do not constitute an international agreement under which the member is obliged to observe its objectives and policies. Since they do not constitute an agreement, nonobservance of the objectives and policies by the member does not constitute a breach of an international agreement. The Fund has made it clear to members that it does not intend to contract when it approves a stand-by arrangement, and hence, an agreement in the legal sense cannot arise between the member and the Fund. A different conclusion could lead to undesirable consequences, in which censorious decisions would follow if a member were found to be in violation of an international agreement by failing to observe its stated economic and financial policies. It must be held in perspective that economic forecasting is uncertain and "the legal consequences attached to nonobservance of economic policies should be commensurate with the state of economic knowledge." The reference in the amended Articles to a stand-by arrangement, defines it as a decision of the Fund

19. Article XXX(b) provides:

Stand-by arrangement means a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount.

20. Gold, *The Legal Character of the Fund's Stand-By Arrangements and Why It Matters*, IMF pamphlet series no. 35, at 2 (1980).

21. See Gold, *supra*, at 43-47.

(not an agreement or contract). Other concepts known to legal analysis such as unenforceable agreements, gentlemen's agreements, and binding unilateral declarations are inadequate to explain the nature of the stand-by. The stand-by arrangement includes obligations arising from the Articles, such as those that require a member to repurchase, pay charges, or to remain in consultation with the Fund. Consequences may follow from a member's voluntary disregard of its stated objectives and policies. Thus, the Fund may take into account a member's record on a request by that member for a subsequent stand-by arrangement. Among the practical consequences of the characterization that is favored, is that members are not required to follow their domestic legal procedures for entry into international agreements, and are not required to take steps to make the stand-by arrangements effective under national laws as if they were international agreements. Moreover, they are not able to register stand-by arrangements with the United Nations under Article 102 of its Chapter, which provides that every treaty and international agreement entered into by a member of the UN shall be registered with the Secretariat and published by it.

The third aspect of the Fund to be noted, is that it constitutes a forum for the consideration of the international monetary system, as well as, the circumstances of individual member countries. The structure of the Fund²² includes a Board of Governors, an Executive Board, a Managing Director, and the staff of the organization. (Provision has also been made in the Second Amendment for a Council, if the Board of Governors decides by qualified vote to call it into existence). The Board of Governors is the senior organ. It consists of one governor and an alternate governor appointed by each member. In practice, the governor is usually the minister of finance, or the governor of the central bank. The Board of Governors meets annually (and may meet more frequently). Its decisions are in the form of resolutions. Powers not conferred directly on the Executive Board, or other organs by the Fund Agreement, are vested in the Board of Governors. In practice, it has delegated those powers that may be delegated under the Fund's Articles to the Executive Board. The Executive Board is the organ that is responsible for the conduct of the general business of the Fund. It is in continuous session. Five of its members are appointed by the five members having the largest quotas, while fifteen others are elected by the other members. (Provision is made to increase or decrease the number of elected members through a qualified vote of the Board of Governors, and for the appointment of two executive directors by the two members that have had their currencies sold by the Fund in the largest net amounts in the two years preceding the election of executive directors if, because of the size of their quotas, they are not entitled to appoint their executive directors). Elections are held every two years. Normally, executive directors are elected by two or more members, but they are constrained to cast all their votes as a unit (instead of splitting their votes in the event of a difference of opinion between the members). This implies that their function is not limited to merely registering the wishes of the countries that form their electorate. Neither the governors, nor the executive directors are described in the Articles as representatives of their members, and Gold, who

22. For a detailed explanation of these matters, see GIANVITI, *DECISION MAKING IN THE INTERNATIONAL MONETARY FUND IN CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW*, vol. 1, at 31 (1999).

wrote extensively on the subject of voting in the Fund (as well as in other international organizations), insisted that "when they take decisions as the Board of Governors or as the Executive Directors, they decide as a body consisting of officers of the Fund, and not as the 'representatives' of the members that appointed or elected them."²³ He was quick to point out, however, that the fact that, although a "governor or executive director votes as an officer of the organ to which he belongs, he does not owe his duty exclusively to the Fund. He is not like the Managing Director and the staff, who 'owe their duty entirely to the Fund and to no other authority.'"

Voting power is determined by quota which, as we have noted, depends on a country's relative economic power. This principle differentiates the Fund from some other international organizations, where the operative principle is one vote for each country. While a parallel might, therefore, be drawn to the concept of an ordinary business corporation, the parallel is not exact, for each member country is entitled to a basic vote, whatever the size of its quota, in a nod at the more traditional concept of the equality of nation states. Tying the dominant power to those members whose economic power was dominant, in turn, was a nod to realism in an organization whose functions were of an economic nature. It also introduced a note of efficiency that might be lacking in organizations based on equality of voting. The membership of the Fund would ultimately exceed 180 countries. If the organization were premised on the assumption that each was to be allowed to have an equal say on every issue, and, by way of example, each was allotted five minutes to explain its point of view, then each issue brought up for discussion would consume fifteen hours (roughly the equivalent of two working days). In the fast moving world of international finance, such a system would be unworkable and would only invite disaster. Decisions would, of necessity, have come to be made exclusively outside the organization and the usefulness of the Fund would have ebbed.

While a complete exegesis of the complex system of voting provided for in the Articles would take note of provisions that deal with adjustable voting power, reserved powers, special majorities, and other aspects of taking decisions, it is especially noteworthy that in practice, most decisions are not taken by a process of formal voting at all. This was not unexpected, for as far back as 1946, Rule C-10 of the Fund's Rules and Regulations provided that while an executive director may require a formal vote to be taken, ordinarily the chairman would "ascertain the sense of the meeting in lieu of a formal vote." Although voting is avoided in this manner, voting power is still important, since the sense of the meeting was explained in a decision of the Executive Directors to mean "a position supported by executive directors having sufficient votes to carry the question if a vote were taken." Gold explained that the Executive Directors try to avoid confrontation politics and seek instead to "reach decisions in which as many as possible of their number, considered as individuals, concurs without reference to their voting strength."²⁴ He explained the rationale as follows:

The Fund has both regulatory and financial functions. It was soon realized that members are more likely to comply with the decisions of the Fund as a regulatory organization, if the

23. GOLD, VOTING AND DECISIONS IN THE INTERNATIONAL MONETARY FUND 99 (IMF: 1972).

24. Gold, *supra*, at 199.

decisions are reached by consensus, or at least widespread concurrence. Members of the Fund as a financial institution can tolerate the idea of the influence of those among them that have greater financial strength. The recognition of this strength encourages those who possess it to act with restraint, and to refrain from the exercise of their greater voting power. The result tends to be an equilibrium, in which the views of the more powerful members may not prevail, but in which decisions will not be adopted in opposition to them before some accommodation can be found.²⁵

The fourth aspect of the Fund is to serve as a source for international liquidity. Traditionally, reserve assets were of three types: gold, foreign exchange, and a country's reserve position in the Fund. During Gold's tenure as General Counsel, a new and innovative reserve asset would be added.

Gold occupied a central role in the reserves of countries. For many years it was valued by the members of the Fund at an official price, which derived from the undertaking of the U.S. authorities to buy and sell gold to monetary authorities at \$35 per ounce. This value reflected the par value of the U.S. dollar, which was equivalent to .888671 gram of fine gold, and the undertaking of the U.S. authorities to maintain the value of its currency under the par value regime established under the Fund Agreement. When private demand for gold began to assert itself, the central banks of several European countries joined with the Federal Reserve in 1961 to conduct sales in the London gold market, in an effort to keep the private price for gold from rising substantially above the official price. Following the failure of this effort in 1967, a two-tier market developed, and the price of gold on the private market rose markedly above the official price. The advantage of holding gold in one's reserves was its universal acceptability to settle financial obligations. However, it did not earn interest or pay dividends, and in fact, a holder of this reserve incurred costs in storing and securing (as well as transporting) it.

Foreign exchange was recognized as a second reserve asset. Foreign exchange has certain advantages over gold. Thus, a holder does not incur storage or security problems and the associated costs. Furthermore, it can be invested so as to earn interest or dividends until it is used. Of course, it is subject to fluctuations in value, and may be subject to restrictions (and for this and other reasons) unacceptable to a creditor in discharge of a financial obligation.

The third reserve asset was the *reserve position of a member country in the Fund*. It was calculated as the extent that the Fund's holdings of its currency were less than its quota in the Fund. It was the result of the payment of the non-currency portion of the subscription by the member, together with the subsequent sale of the member's currency in transactions by the Fund with other members. The right of a member to draw in the reserve tranche is unconditional, in the sense that it cannot be objected to by the Fund (unless the member has been declared ineligible to make purchases).²⁶ Such a drawing carries no charge (and following the Second Amendment to the Fund's Articles, is partly remunerated).

25. Gold, *supra*, at 201.

26. See Article V, Section 3(c) of the Fund's Articles of Agreement.

VI. Clouds on the Horizon During Gold's Tenure: The First Cloud: Disproportion of Reserves to World Trade and the First Amendment's Creation of the Special Drawing Right

As the years passed, the international monetary system seemed to be operating in a generally satisfactory manner. The par value system and the associated rules of conduct had laid the basis for increased trade, and when countries had stumbled into balance of payment difficulties, the resources of the Fund were available to tide them over the difficulties, while they made the necessary adjustments without the more wrenching actions that would have been necessary in their absence. Challenges occurred and required responses, but these were rapidly fashioned with the aid of a highly competent staff. Nevertheless, there were two clouds that were gathering on the horizon. In a way they were interrelated, since both involved international reserves. While one was directly related to the amount of international reserves and provoked a response in anticipation, the second seemed to break upon the world in a sudden and unexpected paroxysm. In both Gold played an important role. He often served, not only as the chief legal adviser, but also as the chief draftsman for the measures that the Fund decided were required. In these exercises he was not, of course, alone in his endeavors. He was in constant collaboration with the economists who were his colleagues, with Management and the members of the Executive Board, and with others throughout the Fund. In seeking to craft the solutions, he often drove himself and the members of his own department at a furious pace, and it is a wonder that he produced, at the same time, a series of monographs and articles explaining the changes.

The first cloud that some observers thought they perceived was the relationship of international trade to the reserve assets that supported such trade, and were available for its settlement. In the postwar years international trade had grown by leaps and bounds, and the dire years of its downward spiral in the thirties were rapidly fading from memory. Competitive devaluations and restrictions on trade and payments, which had characterized the prewar years, were no longer in the ascendancy. Nevertheless, it was noted that in 1958 the ratio of the world's reserves to the volume of imports had been fifty-seven percent. This ratio had fallen to about thirty-seven percent by 1967.²⁷ If this trend persisted, then a time might arrive when the reserves of the world were so disproportionately small, in comparison to the needs of expanding world trade, that a crisis would occur and the system would crash.

The situation was disquieting. Gold described it as follows:

If monetary authorities do not have at their disposition, reserves which they regard as adequate, this could lead to a contraction of world economic activity, and a retreat from liberal objectives, including those expressed in the purposes of the Fund. It is obvious that a world in which all countries aspire to a surplus in their balances of payments, because they lack what they regard as adequate monetary reserves or fear that they may not increase sufficiently, is a world in which expansion as well as logic will be sacrificed. The threat implicit in this prospect was retrogression to conditions in which individual advantage would be sought, and

27. See LOWENFELD, *THE INTERNATIONAL MONETARY SYSTEM* 102 (1977).

defensive measures deployed, without regard to the general welfare. A growing worldwide deflation would be the most likely result.²⁸

Consider a public transportation system whose fares are settled by tokens. If the amount of tokens does not keep pace with the growing number of travelers and the velocity of their use remains constant, then ultimately the expansion of the system must cease, and the circumstances of its cessation will entail disruption. In the case of the public transportation system the solution is apparent. The trend must be discerned, and well in advance of the crisis, additional tokens must be created. The solution to the problem of the world's reserves however, did not seem so straightforward. This is because the composition of the world's reserves seemed to compound the solution to the problem. The proportion of world reserves held in foreign exchange was increasing—reaching over 40 percent in 1967—and most of this amount was held in U.S. dollars and pounds sterling. The pound had been in difficulties on and off over the years, while the dollar, in short supply immediately after the close of the Second World War, was now being pumped abroad by the persistent deficits in the U.S. balance of payments. Many economists were predicting that these deficits would be brought under control. If this were to occur, then a vital source of the world's reserves would be cut off. As for gold, the supply depended on production decisions in its two largest producers, South Africa and the Soviet Union, while the demand for its use as a reserve asset had to compete with the proclivities of investors, speculators, and the jewelry and other industries that employed it in commercial use. With these variables, gold could never be depended upon to furnish a reliable increase in the supply of world reserves.

Various proposals were put forward. The Fund's quotas could be increased, so as to afford each country a greater reserve tranche. But the magnitude of the increases, and the difficulty and delays of obtaining frequent and tailored increases, argued against the adoption of this proposal. Perhaps all currencies could be devalued against the official value of gold, so that the gold held in all countries' reserves would be worth more relative to the settlement of the transactions between the countries. But this could only be a stop gap measure, and could hardly be repeated on a regular basis to keep up with the secular trend of expanding trade. Besides, the effect of a uniform proportionate devaluation of currencies against gold would inure greatly to the benefit of the two chief gold producing nations, whose production would now be worth more. There were many that sought a more equitable solution.

Out of the ferment of ideas, one captured the day. This was to create a new reserve asset whose supply, instead of depending on vagaries independent of the needs of commerce, could be consciously tailored to those needs. The total stock of international reserves and the rate of its growth could be deliberately and carefully calibrated to the growth of world trade. Thus was the *special drawing right* (SDR) born. Gold was in attendance at the birth of the SDR, serving on the team that gave rise to the concept, and supervising its legal expression in the First Amendment to the Articles of Agreement. Gold described its promise as follows:

In the provisions of the Articles that govern special drawing rights, the states that participate in the Special Drawing Account have a potentially powerful mechanism for affecting the

28. GOLD, SPECIAL DRAWING RIGHTS CHARACTER AND USE 7-8.

volume of liquidity available to them, and for helping to avoid economic stagnation and deflation in the world, as well as excess demand and inflation.²⁹

The First Amendment came into effect on July 28, 1969. Subsequent to the adoption of the First Amendment, SDR 9.3 billion were allocated to member countries that became participants in the Special Drawing Account during the period of 1970–1972. Again in 1978–81 a total of SDR 12.1 billion was allocated. The Second Amendment, which came into effect in April 1978, made some notable changes to the system. The intricacies of the SDR are manifold and complex and have been described elsewhere.³⁰ However, to allow a summary understanding of the current system, a few basic points will be mentioned.

The special drawing right was created to serve as a supplement to existing reserve assets. If the Fund decides to allocate SDRs (or cancel them), it must consider the long-term global need to supplement existing reserve assets, so as to promote its purposes and avoid economic stagnation and deflation, as well as excess demand and inflation. There is a special procedure for proceeding to the allocation, in which the Managing Director, the Executive Board, and the Board of Governors all take part. An allocation is made for a basic period, normally five years in duration. The rates at which allocations of special drawing rights are made are expressed as percentages of quotas. All member countries are participants in the Special Drawing Rights Department. Recipients of allocations do not deposit their currency or reserve assets when receiving an allocation. Thus, the effect of an allocation increases the reserves of the recipients without any countervailing reduction in them. Recipients of SDR allocations cannot use them in transactions with private parties. SDRs can be transferred to another participant in return for currency, and the transferor may use the currency received. Two methods of use are contemplated. If a participant has a balance of payments need, but cannot find a participant that will provide currency in exchange for the transfer of SDRs, the Fund may designate a participant to provide a freely usable currency. The more normal procedure is by agreement between participants (or other officially designated holders of SDRs). Rates of interest and charges are applicable to SDRs. They are the same, so that participants holding more SDRs than their net cumulative allocations receive payments, while those holding less must make payments. The Fund holds SDRs in its General Resources Account and is authorized to use them in its operations and transactions, but is not entitled to receive them by way of allocation.

The valuation of the SDR and its interest rate are determined by reference to a basket of currencies. This was not always the case. The initial valuation under the First Amendment was related to gold. However, this was replaced first by a basket of sixteen currencies, and then simplified by reduction to five. The SDR is used as the unit of account in the Fund's General Resources Account, and the value of Fund holdings of member currencies is maintained in accordance with this unit of account. As a unit of account the SDR is also employed by a number of international organizations, and to denominate some financial instruments created in the private market (but these instruments have not given rise to a very large following).

29. GOLD, *SPECIAL DRAWING RIGHTS-THE ROLE OF LANGUAGE 1* (1971).

30. See GIANVITI, *SPECIAL DRAWING RIGHTS, IN CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS*, vol. 5, at 1 (1998).

Although the SDR was intended by the Second Amendment to become the principal reserve asset of the international monetary system, this goal has not been realized and the role of the SDR as a reserve asset has remained limited. The Board of Governors adopted a resolution in September 1997, approving a proposal for a Fourth Amendment to the Articles to the end of providing the authority for a special allocation of SDR 21.4 billion to raise all participants' ratios of cumulative SDR allocations to quota to a common ratio of 29.3 percent. Nevertheless, many observers are of the opinion that the internationalization of finance, and the explosive development of private capital markets, make it unlikely that the SDR will become the principal reserve asset of the international monetary system in the near future.³¹

VII. The Second Cloud: The Demise of the Par Value System: Gold's Counsel to Avoid a Legal Vacuum

While the first cloud (relating to the possible disproportion between reserves and world trade) came to dissipate itself, even while preparations were made to counter its effect should it ever ripen into a serious threat, the *second cloud* that darkened the horizon broke with an extraordinary ferocity and led to a radical change in the international monetary system. It has been mentioned above that the vast dollar shortage that faced most of the countries in the immediate post war world had been reversed and a threat of the opposite nature had appeared. The United States had begun to run persistent deficits in its balance of payments. At first these were believed to be only temporary, but by 1971 the U.S. balance of payment situation was beginning to arouse apprehension both in the U.S. and abroad. The deficit was the result of deterioration in both the trade and capital sectors. There had been an acceleration of imports into the U.S. and an outflow of capital abroad. The largest factor for the deterioration was a sizable increase in short-term capital outflows. These, together with the trade deficit and an increasing outflow of long-term capital, had led to flight at an annual rate of more than \$22 billion during the first half of that year. There was little evidence that the situation would improve.

It may be recalled that the rules of the par value system mandated that member countries defend the value of their currencies in the markets, but recognized that this obligation could be satisfied by buying and selling gold freely with the monetary authorities of other countries for the settlement of international transactions (provided that the price did not exceed the margin prescribed by the Fund for dealing in gold). While other countries had largely chosen to defend their currencies by buying and selling them against an intervention currency, the United States had opted for the latter course. Accordingly, a system had developed in which most countries were active in the defense of their currencies, while the U.S. was the passive centerpiece buying and selling gold from official monetary authorities.

Not all was well. Canada had encountered economic problems and had decided to float its currency. The Fund had no authority to approve a unitary floating exchange rate for a currency, and was counseling a reestablishment of the par value of the Canadian

31. See *Financial Organization and Operations of the IMF*, pamphlet series no. 45 prepared by the Treasurer's Department of the IMF 91 (1998).

currency, and a return by the authorities to the obligations of the Articles. Meantime, speculators and others had begun to sense that the world's currencies had gotten out of kilter with one another and were in need of adjustment. Some believed that a devaluation of the U.S. dollar, or a revaluation of the currencies of other countries, would prove inevitable. A rush developed to buy German marks and other European currencies. The German central bank, attempting to stem the tide, tried to defend the parity of its currency and purchased over a billion U.S. dollars during two days in May. On the next day, May 5, 1971, five European central banks, including the Bundesbank, closed their foreign exchange markets for the rest of the week. The outcome was that when these countries prepared to reopen their exchange markets, Germany and the Netherlands informed the Fund that for the time being, they would not maintain the exchange rates for their currency within the margins: i.e. both the mark and the guilder would float. At the same time, Belgium and Luxembourg notified the Fund that they were changing their regulations to stem large inflows of capital. Austria proposed to revalue its currency to avoid an unwanted inflow of speculative capital, and the Swiss authorities announced a revaluation of the Swiss franc for the same reason.

These measures did little to quiet the turmoil in the foreign exchange markets. In July and early August, an even more massive flow of funds from dollars into foreign currencies developed. Moreover, it was not only actions of the private sector that were causes of concern. By August 15, the U.S. reserve position had deteriorated to such an extent that its liabilities to foreign official authorities exceeded U.S. official reserves by almost \$30 billion. A number of countries that had traditionally held dollars in their reserves began to present increasing amounts of dollars to the U.S. Treasury for conversion into gold. There had been a long time perception that the dollar was "as good as gold." That this perception had grown up, was in part due to the U.S. undertaking to exchange gold for dollars that were presented to it by official monetary authorities. This perception, and the underlying undertaking, had encouraged foreign monetary authorities to keep large portions of their official reserves in U.S. dollars. But the perception fostered by the adage had worked only too well. Ultimately, the dollar balances of foreign monetary authorities exceeded the U.S. gold reserves, and some of the authorities began to eye the dwindling U.S. stocks with apprehension and misgiving. What if a number of authorities presented their claims at the same time? How could the U.S. authorities satisfy all of the country's creditors simultaneously? A foreign monetary authority had responsibility for the safety of its own nation's reserves. Should it wait while others took the initiative, and then find itself at the end of the line when the U.S. gold stock was exhausted? A growing number of countries began to present more of their dollar holdings to the U.S. Treasury for conversion into gold. A gold rush seemed to be imminent. Perhaps the par value system, which had seemingly performed so well, had built into it its own seeds of destruction: when the dollar had been perceived as good as gold, countries were content to increase their holdings of dollars, but when other countries followed suit, and total holdings of dollars came to exceed the gold stocks of the United States, some countries began to act on a changing perception of risk.

On Sunday evening, August 15, 1971, President Nixon announced a series of measures. Among these was the restriction of the conversion into gold of dollars held by foreign monetary authorities. The United States would no longer, for the settlement of international transactions, freely buy and sell gold as it had undertaken under the Fund Articles. The gold window had been shut. Furthermore, the United States would not

take other steps to defend its currency within the defined margins. As Gold subsequently wrote:

The U.S. President's announcement meant that the United States had decided to take an action that could not be reconciled with the Articles. What was the breach involved in this action? It may seem strange that the violation was not the withdrawal by the United States of its declared willingness to buy and sell gold freely for dollars with the monetary authorities of other members for the settlement of international transactions, even though the undertaking had become the real foundation of the system. The undertaking was voluntary. The violation was the refusal of the United States to take other appropriate measures to confine transactions in U.S. territories involving exchanges of dollars, and the currencies of other members within margins that were consistent with the Articles.³²

With some key members of the Fund adopting floating rates, and the U.S. refusing to take measures to defend the dollar, other countries also abandoned their obligations to defend their currencies. International trade had grown by leaps and bounds under the par value system, and many economists believed that there was a causal relationship between stable exchange rates and the expansion of trade. Some believed that the sudden end of the par value system could only be followed by crisis, with the ugly threat of a return to the economic practices that had characterized the era of the nineteen thirties.

Currencies floated, some in harmony with others, some by themselves, some in free float, others attempting by intervention to maintain a controlled float. Despite the chaos in the exchange markets, however, the worst fears of the economists were not realized. With the central obligations of the par value system suspended indefinitely, a legal void loomed. Would the remainder of the Fund Agreement fail, or could some action be taken to save it?

Gold realized the dangers inherent in a legal vacuum and counseled their containment. The chaos of the thirties could not be allowed to reassert itself. Looking back on this period of uncertainty, Gold subsequently wrote:

One of the dangers of prolonged illegality, is that breaches of obligation by some contracting parties will encourage them, or other contracting parties to commit breaches of other obligations, even when there is no legal doctrine of reciprocity under the treaty to justify these breaches. The preference for legality may tempt some contracting parties to argue, or even to act on the contention, that they have been freed by law from inconvenient treaty obligations, even before the due process of amendment has been completed. The damage to international law by breaches of obligation is aggravated by unsound doctrine designed to clear the breaches of the odium of illegality.³³

32. Gold, "Strengthening the Soft International Law of Exchange Arrangements," 77 AM. J. INT'L L. 443, at 447 (1983). Gold further noted: "Another violation was the refusal of the United States to convert official holdings of dollars in accordance with the complex, but limited, obligation of official convertibility under Article VIII, section 4 that all members had to observe once they undertook to perform the obligations of convertibility under Article VIII, sections 2, 3, and 4. If a member gives notice that it will perform these obligations, it cannot shed them at a later date."

33. GOLD, LEGAL AND INSTITUTIONAL ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM: SELECTED ESSAYS 8 (1979).

There was language in the Fund's Articles that mandated a duty of collaboration from its member countries. In considering this language in Article IV, Section 4(a), Gold wrote: "After August 15, 1971, the provision became almost the only source of authority for the Fund's efforts to adapt itself to a situation in which some major assumptions of the Articles had suffered seismic shock, and to control the dangers inherent in widespread illegality."³⁴

There was no time to lose. The Fund took a decision that was cabled to all its members. Taking note of the crisis, the decision simultaneously reminded members of their continuing obligations. Since one of the obligations of members was that of collaboration with the Fund to preserve the objectives of the Articles, the decision emphasized "the undertaking of members to collaborate with it to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations"

The strategy was effective to contain the damage. The members did collaborate. They met together at the Fund's annual meeting in September amid somber talk of the possibility of a trade war. Nevertheless, discussions were never broken off. They proceeded in many forums. The finance ministers and central bank governors met in Washington in December 1971 to hammer out the Smithsonian Agreement, which envisaged devaluation of the dollar and, for countries unwilling to observe their former par values, a new set of extra-legal "central rates," as well as wider margins, than those of the Articles for all members. Central rates were communicated to the Fund by twenty-eight members that, while not maintaining rates based on their former par values, were nevertheless declaring their intention to maintain rates for spot transactions within the new maximum margins. The measures had saved the day until a more permanent solution could be crafted. They allowed a number of the Fund's members to realign their rates within an acceptable flexibility, while the majority of the Fund's members kept their exchange rates unchanged in terms of their intervention currency, without availing themselves of the wider margins.

The official history of the Fund described the quasi-legal innovations as follows: *Central rate* was not a term used in the Articles of Agreement. Moreover, under the existing Articles, the Fund lacked the authority to substitute wider margins for those specified in Article IV, Section 3. However, the legal basis for a temporary regime of wider margins and central rates, according to the General Counsel, was Article I (iii) and Article IV, Section 4(a), relating to the basic purposes of the Fund, and to members' obligations to collaborate with the Fund in order to promote exchange stability, to maintain orderly exchange arrangements, and to avoid competitive exchange alterations. According to the General Counsel, in situations in which members did not observe sections 3 and 4(b) of Article IV, it was Section 4(a) of Article IV that was the main provision under which the Fund and members could collaborate, in order to do their utmost to preserve the objectives of the Articles³⁵

The day, may thus have been saved and the world allowed a breathing space. But a more permanent solution would have to be found. The Smithsonian Agreement unraveled rapidly. A number of members returned to floating rates, and on February 12, 1973

34. GOLD, *supra*, note 32 at 35.

35. DE VRIES THE INTERNATIONAL MONETARY FUND 1966-71, at 558 (1976).

the United States proposed a further devaluation of the dollar that became effective in October of that year. Many negotiations followed. Ultimately the provisions that were to become the Second Amendment to the Fund's Articles would be agreed.

VIII. The Second Amendment to the Fund's Articles of Agreement: Gold's Role as Chief Legal Draftsman

The Second Amendment, which came into effect in April 1978, involved extensive amendments to the Fund's Articles. It is not possible here to explore all of their many manifestations. A few of the changes may be mentioned that are relevant to the narrative of this paper. Comprehensive new provisions were incorporated to reduce the role of gold in the international monetary system, and to make the SDR the principal reserve asset of that system. Gold would no longer be the common denominator for par values (which have disappeared during the current regime), and the SDR is no longer valued in relation to gold. Payment of one quarter of the subscription of a member is no longer in gold. It is paid in SDRs, foreign currencies, or the member's own currency. There is no longer recognition of an official price of gold. Thus, sales of gold by the Fund are to take place on the basis of market prices. Improvements were made in the SDR, with the intent of providing greater freedom in its use. The par value system is gone, although there is a possibility of its being called back into existence in a very different form. In place of the old rigid rules, there is recognition that members may select the exchange rate arrangements of their choice. These may include the maintenance by a member, of a value for its currency in terms of the SDR or another denominator, other than gold, or in relation to the value of the currency of another member, or other exchange arrangements. Floating exchange rates are no longer barred. The obligation to collaborate with the Fund has been retained, and additional content has been incorporated into it. The Fund is to exercise firm surveillance over the exchange rate policies of members, and adopt specific principles for the guidance of all members. A Council may be called into existence through a qualified decision of the Board of Governors. In addition, the Second Amendment contained provisions that modernized the financial transactions and operations of the Fund. It also increased the number of decisions that must be taken by qualified majorities.

Gold served as the chief draftsman of the Second Amendment. He also took a leading part in the negotiations that produced the agreements and compromises, serving on various working groups, writing memoranda, and explaining the proposals to member government officials. The task of developing the new amendment was long and arduous. Gold summarized the effort: "When the Second Amendment of the Articles of Agreement of the International Monetary Fund took effect, one of the most extensive and laborious revisions of a major multilateral treaty had been completed."³⁶ The Managing Director, Mr. Pierre-Paul Schweitzer, had stressed that the amended Articles must have a flexibility that was lacking in their predecessor. He had said:

[N]ew arrangements will have to be flexible enough to respond to changing circumstances and unforeseen developments. As far as possible, they should be based on broad principles,

36. Gold, *supra*, note 32 at 4.

rather than over-elaborate formulae. We must be prepared, therefore, to equip the central institution of the system with the power to adapt itself to developing circumstances, and to deal quickly with crises should they nevertheless arise.³⁷

Gold and his colleagues responded to the challenge. When the exercise was finished, he characterized the result as a "conscious effort . . . to draft in terms of broad principles and to leave scope for the development of policy." He knew that the Fund and, indeed, the international monetary system were not merely a scholarly amalgam of economics and law, but however essential these ingredients. There was always the need to recognize the role of politics. He wrote:

In a number of provisions, the Fund is instructed to adopt policies for the conduct of certain operations and transactions without any indication of what those policies might be. The flexibility that is a feature of some provisions, however, must be attributed not to reason, but to a failure to reach full agreement. The discordance responsible for this flexibility, may produce better results than the harmony that has permitted the incorporation in both the First and Second Amendments, of certain policies that had already been developed by practice . . .³⁸

In the end, he was optimistic that the laborious revisions of the Fund's Articles would provide a new and sounder basis upon which to construct the principles and practice of an orderly international monetary system.

IX. Epilogue

Gold continued to write and to lecture following his retirement as General Counsel. Articles, books, and correspondence flowed from his pen. He maintained an office in the Fund, and sought to resist the encroachments of age through continuing dedication to the work he had loved so long and so well. The years passed. In time, he suffered a series of strokes that left him with a severe limp, but diminished neither his fervor nor his wit. He lamented the days that illness and the advancing years stole from his long established regime. But the biblical prophecy of the end of days is stayed for no man:

Or ever the silver cord be loosed, or the golden bowl be broken, or the pitcher be broken at the fountain, or the wheel broken at the cistern. Then shall the dust return to the earth as it was

Gold died during the millennial year at the age of 87, full of years and accomplishment. His life had spanned the two great wars and the intervening depression. It had also encompassed the postwar era, by which time he was able to play an important role in his chosen field of international monetary law.

In the 1930s there had been little jurisprudence that served as a basis for the international monetary system, and little infrastructure that could properly be called an international civil service. It was at that time, that the Great Depression spread unhindered from one country to another, like an epidemic casting its shadow over the economics and politics of the times. Deteriorating economic conditions, and the rise of lawlessness

37. IMF SURVEY, vol. 2 (1973) 203, quoted in Gold, *supra*, at 25.

38. Gold, *supra*, note 32 at 27.

among men had led, ultimately, to the disregard for law by their governments. Even as prosperity and law tend to go hand in hand, so poverty and lawlessness are handmaidens, as well. The chaos and misery of the times had contributed to the causes of the Second World War.

After the war, a new attempt had been made to found a true international monetary system based on principles of law. It worked well for a quarter of a century. When it finally broke, there was a competent and experienced international civil service that proved instrumental in guarding against a return to the mistakes of the thirties. It was able to contribute to the reconstitution of a new and improved international monetary system that is with us today. Crises have not been abolished and are sure to recur, for we live in accelerating times. But the jurisprudence and institutional knowledge are available to deal with them.
